REDW Benefits LLC

INTEGRITY COUNTS.

FSA GUIDELINES

Nondiscrimination Testing

Eligibility Test

The IRS requires that plan eligibility be fair, consistent, and reasonable. Eligibility tests show that eligibility is not limited to or weighted in favor of key or highly compensated employees. Thus, self-funded plans (such as a flexible spending account) may not exclude non-highly compensated employees from participating in favor of highly compensated or key employees. IRS regulations do, however, permit the exclusion of certain groups of employees, including:

- Employees with less than 3 years of service
- Employees under age 25
- Part-time or seasonal employees
- Non-resident aliens
- Collective bargaining employees

The eligibility test is a two part test. The first test stipulates that no employee be required to complete more than three years of employment as a condition for participation and that the employment requirement for each employee be the same.

The second part of the test requires that eligibility must not be discriminatory in favor of highly compensated employees, who are defined as any of the following:

- officers
- shareholders who own more than 5%
- employees who earn over $90,000
- spouses or dependents of any of the above

The test is usually met if all employees are eligible to participate. However, care must be exercised in designing a plan that either covers only a segment of the employees or has only a small percentage of employees participating. The latter situation often occurs with FSAs. Generally, to satisfy eligibility requirements, a plan must benefit:

1. 70% or more of all non-excludable employees, regardless of whether they are highly or non-highly compensated; and
2. 80% or more of these employees who are eligible to benefit; and
3. Employees qualifying under a classification that does not discriminate in favor of highly compensated employees.

Benefits Test

Health Benefits: Under the safe harbor rule for cafeteria plans covering health benefits, a plan is not discriminatory if the employer contributions, including salary reductions, on behalf of each employee equals 100% of the health benefit cost for the majority of highly compensated participants; or 75% of the cost of the most expensive health benefit coverage elected by any similarly situated participants.

Dependent Care Benefits: This test demonstrates that the average benefits received by non-highly compensated employees are at least 55% of the average benefits received by highly compensated employees. A highly compensated employee is defined as:

1. An owner of at least 5% of the company in the plan year being tested or in the 12 months prior the plan year being tested.
2. An employee with gross annual compensation before deductions over $90,000 in the 12 months prior to the year being tested (if the employee is hired in the current year and earns over 90K in the current year they are not considered highly compensated, unless they are an owner).

Concentration Test

A cafeteria plan is nondiscriminatory if no more than 25% of non-taxable benefits are provided to key employees. Key employees are defined as:

1. An owner of at least 5% of the company
2. An owner of at least 1% of the company with gross annual compensation over $160,000 (indexed)
3. An officer with gross annual compensation over $130,000

This test is a particular problem if an employer has a large percentage of key employees and if key employees, being higher paid, contribute large amounts to an FSA. If a plan fails the concentration test, key employees must include the amount of their election in gross income.